



Cooperative Management Series

Directors' Legal Handbook

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I

Introduction

Boards have a fundamental obligation to the member-owners to protect the investment that the members have made in the cooperative. Members must be able to completely trust the Board to make decisions for them. The directors and officers of a company, a cooperative, or a non-profit entity, are, in the performance of their duties, under obligation of trust and confidence to those they represent, and must act in good faith and for the interests of the corporation, organization, or association and its stockholders.

It is the duty of directors to see that an organization keeps within its authorized powers and obeys the law. Any intentional deviation or negligent departure from these duties to the substantial injury of the company may result in personal liability.

II

Basic Director Responsibility

The Board of Directors is responsible for the overall administration of the Company's affairs. A Director's duty is to direct, not to be led. General areas of responsibility of a Board of Directors are:

1. **Fiduciary responsibility:** Developing a competitive base to promote growth, profitability, and an equitable return to the members while keeping the Company in compliance with applicable laws.
2. **Establishing policy:** Review and establish policies and procedures for the Company, ensure for the management to operate the day-to-day affairs in the implementation and the execution of the policy.
3. **General supervision of operation:** The Directors should provide the general overall supervision of the operations of the Company through its employed management. The Director's responsibility is not to manage, or participate in hands-on operation of the Company, but to review and supervise its management team.

4. **Powers of Directors:** All corporate power is held by the Board of Directors with only a few exceptions.

- (A) Corporate Directors have no authority to act for or on behalf of the Corporation, or to bind the Corporation in dealing with Third Parties, except by executing their office in a duly convened meeting of the Board; unless they have been specifically authorized by Resolution duly adopted by the Board itself.
- (B) Directors monitor the performance of Management, establish long and short-term goals, set objectives and measure Management's results against them, and be responsible for the selection and removal of the Manager.

Examples of current powers:

- Borrow money
- Retire equity
- Issue mortgages
- Accept members
- Expel members
- Establish prices
- Employ personnel
- Contract services
- Provide authorization
- Review investments
- Implement audit procedures
- Review financial statements
- Call member meetings
- Choose banks
- Adopt budgets
- Adopt work plans
- Elect officers
- Approve basic direction
- Render advice and counsel

5. **Legal Limitations of the Board:** Directors are not expected to conduct "Hands on, day by day" actual management of the Corporation.

Examples of legal limitations:

- Amendment of a charter
- Call a special meeting
- Request removal of a director
- Dispose of substantially all corporate assets
- Amend bylaws
- Agree to merge or consolidate
- Dissolution

III

Legal Duties of Directors

Over the years, through a combination of statutory law and common law, three legal basic duties have evolved that are imposed on individuals who serve as directors or officers. The three legal basic duties are: the duty of due care and diligence, the duty of loyalty, and the duty of obedience.

1. The duty of due care and diligence: *"Attending to Business"*

- (A) Directors are required to conduct business with the same degree of fidelity and care as an ordinarily prudent person would exercise in the management of their own affairs of like magnitude and importance.
- (B) Business Judgment Rules:
 - (1) Directors hold their office charged with the fiduciary duty to act according to their best judgment.
 - (2) Directors are liable for negligence in the performing of their duties, but they are not liable for errors of judgment or for mistakes while acting with reasonable skills and prudence. Directors are not required to make "the" perfect decision; but they are required to make an informed decision.
 - (3) Directors must seek information before making a decision and must reason out the apparent proper cause of action.
 - (a) Directors may be held liable if they makes a decision or takes action without obtaining adequate information.
 - (b) Directors will not be held liable if they relied on information from an allegedly competent source such as a corporate president, accountant, consultant, or attorney.
- (C) Attendance at meetings and knowledge of agenda
 - (1) Directors are not required to attend all meetings, but must attend a reasonable number.
 - (2) Directors who attend a meeting is presumed to have assented to all action taken at that meeting unless they registers their dissent.
 - (a) Written dissent may be filed with the board secretary sent by registered mail.
 - (b) Written dissent may be filed with the secretary of the meeting before adjournment.
 - (c) Dissent may be entered into the minutes of the meeting.
 - (3) Abstaining from voting or "present but not voting" does not eliminate potential liability. A specific dissent is required.
 - (4) If Directors are held liable for improper action at meeting, and dissenting Directors did not properly register their dissent, they will also be liable.
 - (5) Directors will be presumed to have knowledge of the agenda at a meeting, even if they were not present.

(D) Responsibilities of Director under the Model Business Corporation Act:

- (1) All corporate powers are to be exercised by or under authority of a Board of Directors.
 - (a) The business and affairs are to be managed under direction of the board.
 - (b) Directors are executive representatives charged with administration of internal affairs and management and use of assets.
- (2) Directors must act in behalf of the entity and its management.

(E) Checklist for elements of "prudent man rule" for a Director's duty of due care:

- (1) Regularly attended board and committee meetings.
- (2) Digested and questioned where necessary all material furnished between meetings, including minutes of past meetings, proposed agenda, proposals, and financial statements.
- (3) Participated in board discussions, both major and minor.
- (4) Made independent inquires as needed.
- (5) Registered objections when appropriate.
- (6) Reviewed company reports.

2. The duty of loyalty: *"Avoiding Conflicts of Interest"*

- (A) Directors must conduct themselves in the best interests of the association.
 - (1) Directors have the duty to fully disclose any conflict or interest of any self-interested transactions.
 - (a) When dealing with his own interests, the transaction must be:
 - (1) Approved by a majority of disinterested directors, or;
 - (2) Approved by a majority of shareholders, and;
 - (3) Inherently fair to the association.
 - (b) Whenever directors personally benefits from their office, there may be a presumption of fraud.
 - (c) Self-dealing is usually considered a breach of duty.
 - (2) Directors cannot engage in competing business to the detriment of the association.
 - (3) Directors may not usurp an association opportunity.
 - (a) The business opportunity must first be presented to the association; Directors may engage in the business opportunity only if association is unable to do so, or chooses not to.
 - (b) Directors who usurp an association opportunity is presumed to be holding it in trust for the association.

- (4) Directors have no right to utilize confidential information acquired while in a strategic position of trust for their own company's or personal benefit.
 - (B) Directors who knowingly and wrongfully violate their fiduciary duties will be jointly and severally liable for an resulting harm to the association.
 - (C) Directors must act in behalf of the association in its management.
 - (D) Directors cannot enter into agreements, either among themselves, with stockholders, or third parties, by which they abrogate their independent judgment.
 - (E) Directors are responsible for their own wrongful use or diversion of the association information, material, or property, and are accountable for any profits made thereby.
3. **The duty of obedience:**
Insuring "the Company Obeys the Law"
- (A) Directors must operate within the authority granted by the articles of incorporation, the bylaws, and any statutes or regulations.
 - (B) Directors are responsible for assuring that the association does not act outside its authority.
 - (1) Directors can only bind the association when they act at legal meeting of the board of directors.
 - (2) Directors cannot ordinarily bind the association while acting in their individual capacity.
 - (3) Directors must establish policies and procedures and ensure their execution.
 - (4) Directors must supervise operations through management.
 - (C) Directors may be held liable to third persons if they fail to oppose action that is outside the authority of the association.
 - (1) Corporation may indemnify director if he acted in good faith within his authority as a director.
 - (2) Corporation may not indemnify directors if they acted in bad faith or outside their authority.

IV

Director's Duty of Confidentiality

The issues of confidentiality have become a major focus of individuals serving as directors. As the result of service to the company, directors gain special access to otherwise privileged information, not only of the company, but of individual private customers. Under today's contemporary legal standards, directors are held to a high standard for individual matters that legally may not be of general public knowledge or concern:

1. **Competitive issues:** Directors must maintain the

confidences and trade secrets of the company. Specific information of the company's business plans, financial matters, goals, or strategies must be maintained with a high level of confidence. Disclosure of such information outside the boardroom could greatly jeopardize the trade secrets of the company and cause economic loss.

2. **Insider information:** Directors should not personally benefit as the result of "inside" knowledge gained as the result of their access to information or a director. In addition, directors should not utilize their position as a director to cause a personal benefit resulting from an otherwise normal transaction of the company. This is common-law conflict of interest for which personal liability may result.
3. **Individual privacy:** Directors often have access to the private information of third-party customers, vendors, or individuals who transact business with the company. Such information involves the personals privacy rights of such individuals and should not be utilized or "gossiped" by directors outside the direct scope of their official duties.

V

Conflicts of Interest

General duty of director is to serve in "Good Faith."

1. **Instances that may constitute conflicts of interest:**
 - (A) Buying or selling land from or to the Company.
 - (B) Lending to or borrowing money from the Company.
 - (C) Buying or selling supplies, equipment, insurance, or other services from or to the Company.
 - (D) Owning interest in the bank where company deposits its money.
 - (E) Owning interest in business dealing with the Company.
2. **The Law looks with suspicion on such dealings: a court may:**
 - (A) Void the transaction from its beginning.
 - (B) Void the continuation of the transaction.
 - (C) Affirm the contract but assess damages against the Director.
 - (D) Affirm the transaction as being in the best interest of the Company.
3. **If Directors are involved with a conflict of interest**

transaction to the Company, the following should be done:

- (A) Directors should make a full prior disclosure to Board and answer all Board questions.
- (B) Directors should remove themselves from all Board discussions by leaving Boardroom.
- (C) Directors should take no part in the above.
- (D) Directors should keep the Board fully informed of any developments that may later affect the transaction.

VI

Potential Director Liability

Each potential Director has certain liabilities that come with the job.

Examples of liabilities that directors have:

- Filing false reports
- Misrepresentation in the sale of bonds or securities
- Violation of member's rights in equity redemption
- Violation of member's rights to inspect books and records
- Losses occurring because directors did not attend to duties
- Violation of bylaws
- Speculation or permitting speculation
- Negligence in handling of accounts receivable collection.

VII

Avoiding Liability: Financial Issues

The board along with the directors should keep updates of the financial statements close for responding circumstances.

- 1. Boards should regularly review all financial statements to stay informed.
- 2. Respond to any issues identified by auditor or warehouse examiner.
- 3. Understand grain hedging program and have implement appropriate controls.

VIII

Types of Legal Actions Against Directors

- 1. **Civil action:** Recovery of private rights or to redress a wrong committed by Directors, which is not a crime or misdemeanor.
- 2. **Criminal actions:** Brought by the state to punish a person charged with a public criminal offense.
- 3. **Direct actions:** Brought by members, competitors, or government agencies or persons contractually wronged by the board's actions.
- 4. **Derivative action:** Brought by members and/or stockholders on behalf of the Company to right a wrong against the Company, which the Board causes or refuses to address.
- 5. **Class action:** Brought by one or a number of persons on behalf of all persons in a designated class, i.e. if Board fails to pay capital credits/dividends.

IX

Legal Actions/Allegations/Lawsuits

1. Claimants:

- (A) Other members of the board.
- (B) Stockholders derivative action on behalf of individual members or stockholders.
- (C) Third party action by:
 - (1) A competitor
 - (2) A consumer or consumer group
 - (3) A federal or other regulatory agency

2. Cause of Action (examples):

- (A) Breach of one of the director duties.
- (B) Mismanagement.
- (C) Conflict of interests.
- (D) Self-dealing.
- (E) Excessive salaries or dividends.
- (F) Exceeding authority of Charter.
- (G) Failure to stop action resulting in damage to the Company.
- (H) Failure to attend directors and officers meetings.
- (I) Excessive use of company funds.

- (J) Incurring increasing penalties of governmental entities.
- (K) Discrimination.
- (L) Failure to disclose material facts.
- (M) SEC and FTC violations.
- (N) Act of bad faith.
- (O) Violation of any state or federal law.
- (P) Refusal to fairly consider tender offers (i.e. "hostile takeover") to buy out the company.

X

Recommended "Do's" and "Don'ts" for Directors

1. Don't:

- (A) Use the director position for personal gain of any kind.
- (B) Accept gifts, fees, loans favors, or anything of value if it gives any appearance of inducing the Director to compromise Board responsibility.
- (C) Attempt to privately use the company manager and employees to gain detailed, special, or in-depth information for the purpose of dominating Board Meeting discussions. In-depth and special information is available to individual Directors, only with Board approval.
- (D) Disclose details of Board meetings to those who have no need to know.
- (E) Appeal a decision held by the majority of the Board directly to the membership when an individual Director supports a minority view.
- (F) Never ask for special treatment, favors, or concessions from the manager or employees for an individual Director or his or her constituents.
- (G) Give instruction, directions, or orders on conducting the daily affairs of the company to the manager or other employees.
- (H) Question employees, other than the manager about internal situations or company problems.
- (I) Deal with employees except through or with the manager.
- (J) Make commitments as an individual Director in the

name of the Company.

- (K) Embark on a personal investigation or audit of the company's operations without Board approval.
- (L) Fail to adopt a meaningful executive compensation plan.

2. Do:

- (A) Attend meetings diligently.
- (B) Accurately record the minutes of the meeting.
- (C) Have your dissenting vote on Board action recorded in minutes.
- (D) Be on time to meetings.
- (E) Be attentive.
- (F) Become informed, study you information packet prior to meeting.
- (G) Attend your industry meetings and seminars to keep abreast of the changing time.
- (H) Ask questions until you are fully advised.
- (I) Make your own best decision, based on the information you have on the issues. If information is insufficient - postpone decision until better advised.
- (J) As a Board, appraise the manager's performance at least annually and discuss the results with the manager.

XI

Voting Procedures

The following is a general summary of parliamentary law regarding the basic methods of voting. Of course, a Board of Directors can choose any method of voting which it feels is appropriate and fair under the circumstances, but the following are generally accepted voting methods.

1. **General Consent:** The Chair simply asks if there is any objection to the proposed action. If no objection is expressed then the matter is listed as approved. This is generally done with routine and minor items including such things as approval of the minutes or procedural matters. If any objection is noted, then one of the more formal voting methods below should be utilized.
2. **Viva Voce Vote:** Voice Vote. This is done by yeas and

nays in which the Chair asks “all those in favor vote yes” and “all those opposed vote no” and announces for the record that the action has either passed or failed. Any member of the board has personal privilege to request this method of voting over a General Consent vote.

3. **Division Vote:** This is a vote of counting whereby the Chair counts those in favor and those opposed either by having directors raise their hand or stand. The Chair then announces for the record the exact vote count (12-0 for or against, 10-2, 7-5, etc.) without listing how each director voted. Each director has personal privilege to request a Division Vote instead of General Consent or Voice Vote.

Note: Any member who wishes his vote specifically recorded (either “yes” or “no”) in the minutes for any of the above three votes should so inform the secretary by the conclusion of the meeting. Otherwise, no specific names are identified with any of the above votes in the minutes as to how they voted; each individual director is presumed to have voted with the majority. Generally, boards will try to reach a consensus on an issue and present a unified front on an issue.

4. **Roll Call Vote:** This vote is taken by having individual directors specifically express their preference, with each name and vote being recorded in the minutes as to how they voted. This may be done by various methods including the calling of the roll during which a director writing down his vote, signing his name, and passing it to the Chair who then announces each individual name and vote. It takes consent or approval by a majority of the board for a Roll Call Vote. Generally it is done by motion and second, and cannot be done by simple personal privilege. However, if a less formalized vote is utilized, individual members can still request the secretary to record their individual vote for purpose of the minutes.
5. **Ballot Vote:** This is the traditional secret vote by written ballot. Unless required by the bylaws, a majority of the board must approve voting by secret ballot. Generally, secret ballots are utilized only for elections of persons to serve as directors or officers.

6. **Change of vote:** A director has the right to change his

or her vote up until the time the vote is announced by the Chair, unless the vote is by secret ballot.

7. **Counting the Vote:** The Chair counts the vote, but may ask the secretary to assist, or the Chair may appoint tellers to count votes.
8. **Announcing the Vote:** The secretary, or tellers, after tallying and reading the report of the vote, hand the results to the Chair, who then announces the results. A vote is not effective until announced by the Chair. Any member's vote may be changed up until the announcement (except a secret ballot vote).
9. **Proxy Vote:** Proxy vote if permitted by bylaws, may be done by an absent director who authorized another director, generally in writing, to vote in his absence. The proxy can be a specifically limited proxy or a general proxy, within the discretion of the absent director.

10. **Miscellaneous:**

- (A) No director can be compelled to vote.
- (B) On tie votes, the motion is not carried.
- (C) When the Chair is also an individually elected and voting director, it is the Chair's prerogative whether or not to vote on any matter.
- (D) The Chair may vote on any issue. The Chair may vote to make a tie or to break a tie, unless the vote has been cast by secret ballot.
- (E) Those directors who do not vote are counted for “quorum” purposes, but otherwise are not counted in deciding whether it is a majority, a two-thirds approval, or a unanimous vote.
- (F) All blank ballots or non-voting directors are ignored for the purpose of passing a matter.

Answers to Frequently Asked Questions

- (1.) The Oklahoma Open Meetings Act does not apply to Cooperative Boards.
- (2.) Members are not automatically eligible to attend Board Meetings. They may be excluded under certain circumstances.
- (3.) Members are not automatically entitled to membership or financial records. This may also be prohibited under certain circumstances.
- (4.) Employees with access to funds should be properly bonded.
- (5.) Board Members are entitled to advice by attorneys when deemed necessary by the Board.
- (6.) Encourage the Board to adopt a continuing education policy for the Board Members for their own and the association's best benefit.

This publication provides a general guide to the legal responsibilities of a cooperative board member. Because laws and regulations are subject to change, the reader is encouraged to verify the application of laws and regulations to their specific business situation before making major management decisions. **This material is not intended to substitute for professional legal advice.** Cooperative board members and other interested parties with specific legal questions should obtain advice from an attorney who is well versed in federal, state, and local laws regarding cooperatives.

The Oklahoma Cooperative Extension Service

Bringing the University to You!

The Cooperative Extension Service is the largest, most successful informal educational organization in the world. It is a nationwide system funded and guided by a partnership of federal, state, and local governments that delivers information to help people help themselves through the land-grant university system.

Extension carries out programs in the broad categories of agriculture, natural resources and environment; family and consumer sciences; 4-H and other youth; and community resource development. Extension staff members live and work among the people they serve to help stimulate and educate Americans to plan ahead and cope with their problems.

Some characteristics of the Cooperative Extension system are:

- The federal, state, and local governments cooperatively share in its financial support and program direction.
- It is administered by the land-grant university as designated by the state legislature through an Extension director.
- Extension programs are nonpolitical, objective, and research-based information.
- It provides practical, problem-oriented education for people of all ages. It is designated to take the knowledge of the university to those persons who do not or cannot participate in the formal classroom instruction of the university.
- It utilizes research from university, government, and other sources to help people make their own decisions.
- More than a million volunteers help multiply the impact of the Extension professional staff.
- It dispenses no funds to the public.
- It is not a regulatory agency, but it does inform people of regulations and of their options in meeting them.
- Local programs are developed and carried out in full recognition of national problems and goals.
- The Extension staff educates people through personal contacts, meetings, demonstrations, and the mass media.
- Extension has the built-in flexibility to adjust its programs and subject matter to meet new needs. Activities shift from year to year as citizen groups and Extension workers close to the problems advise changes.

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